August 25, 2008

Via email regcomments@ncua.gov

Ms. Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Ms. Rupp:

Royal Credit Union (RCU) is pleased to comment on NCUA's Notice of Proposed Rulemaking for 12 CFR Part 723 regarding potential changes to the Member Business Loan regulations. We commend the Board on considering these regulations in order for credit unions to better serve their business members' expanding needs.

RCU is a state chartered community credit union established in 1964 with current assets totaling approximately $900 million. We have been successfully making MBLs for 26 years. Our staff of 20 business loans and services professionals has a wealth of banking and commercial lending expertise. Our current staff has over 230 years of combined commercial lending experience. The writer and manager of the department has over 37 years of commercial lending experience, all four of the other lenders have more that 20 years experience, our operations supervisor is a former commercial lender and has over 20 years commercial lending experience, and finally, our credit department supervisor also has more than 20 years of commercial experience.

We understand and agree with NCUA's role to maintain the safety and soundness of the credit union system. We also understand and take seriously our mission to safely assist our business members and the services, products, benefits, and employment they in turn bring to the communities we serve.

However, before we comment specifically on Part 723, we would like to express some observations.

1. We would like to note that credit unions are the only type of financial institution that have a separate and specific regulation for commercial lending.
2. We are of the opinion that regulations cannot "legislate" safety and soundness in and of themselves. We also feel the current MBL Rule has a strong collateral bias and perhaps gives a false sense of security. We all should know that cash flow pays back loans and collateral seldom is sufficient to prevent a loss. This is especially true for business loans.
3. We feel that lender experience is an extremely critical component of any MBL program and goes much further in preventing losses than collateral, however, experience is not emphasized or detailed in any way in Part 723

except for the two year minimum requirements. Frankly, we are concerned when we observe some of CU personnel who are currently making member business loans and some of inadequate systems that are being employed. We will comment in detail later in the correspondence.

4. We consistently find ourselves at a competitive disadvantage with community banks and thrifts because of some of the provisions of Part 723. Again, we will comment in more detail later.
5. While the intent of Part 723 is to increase the safety and soundness it ironically often has the reverse effect. It is basically the concept of "adverse selection." Please let me explain what I mean by that term in this context. The highest quality borrowers often will not accept or tolerate the relatively more restrictive provisions of Part 723 and select other competitors. This often leaves the credit union with those borrowers that don't have the same freedom of choice due to their lesser credit quality characteristics, over a span of time this reduces the quality of the whole portfolio. A possible solution to some of the anti-competition restrictions is a waiver. However, we have found the waiver process to be laborious, duplicative (i.e. need to submit the same voluminous information with each waiver request regardless of the time lapse) and not timely enough to prevent high quality borrowers form going to another lender/competitor.

As previously indicated, the following are some specific comments/suggestions:

A. Lender experience and infrastructure requirements.

Expanding on the comments in #2 and #3 above we would offer:
The current two year experience requirement is totally inadequate; we feel it should be at least five years and perhaps as much as ten years. Admittedly this would prevent many credit unions from having their own MBL department. However, in cases where a credit union can not or does not want to meet the minimum experience requirement, there are now several CUSOs and other third party providers who they could access and contract with until they are willing to make their own commitment or perhaps they simply continue with the third party(s) and are able to service their members and communities with that model. In general the MBL Rule places far too much emphasis on collateral, and far too little on lender experience, staff experience, and infra structure (e.g. data processing, follow-up, maintenance, analysis, and monitoring software and systems). There can be significant exposure on existing loans if they are not monitored by proper systems and by experienced personnel.

We previously cited the experience level of our current staff and we feel we have validated the above premise with our loss experience record.

- RCU had over $249 million in outstanding Member business loans as of December 31, 2007.
- RCU's total CUMULATIVE losses in the Member Business Loan Department for the past 16 years (1991-2007) have been

$1,287,417, an average of 80,464/year or 0.032%. The total is somewhat skewed by a single loss of $593,337. The subject loan was not real estate secured. Without the single large loss, the cumulative amount is $694,080, the average drops to $43, 880/year and the ratio goes down to 0.017%

B. LTV Ratio Requirements

As previously mentioned we have successfully been making MBLs for 26 years, and we agree that C & D loans have the potential to be riskier. However, we have made hundreds of construction loans without any losses. We feel strongly that C & D loans should be split into two categories. There is a huge difference in the risk profile between a construction loan for an eight unit residential property and a subdivision development. We find ourselves consistently at a competitive disadvantage when competing with community banks and thrifts for conventional low risk residential and commercial construction loans. We would strongly advocate a definitional division into two categories:

1. <u>Construction</u> loans which would include residential, office, and commercial structures.
2. <u>Development</u> loans, which would include subdivisions, land developments, and other like developments.

To prevent excessive exposure in category number one above, to, for example, large high rise condos, perhaps there could be a dollar/percent limit based on the credit union's net worth or just an absolute limit based on number of units (e.g. 96 or less units). We would further propose a lower LTV of 65% or maybe even lower for category number two (development loans).

This proposal to split C & D loans into the above two categories would significantly reduce our competitive disadvantage without, in our opinion, increasing risk. It would allow us to better serve our members and communities.

Multiple LTV tiers would again complicate the already unwieldy rule. However, we feel it would be appropriate to have a very limited number of tiers as follows:

Up to 65% - for development loans

Up to 80% - for all other types of loans, <u>including</u> construction loans.

Up to 100% - for small vehicle fleets and for loans secured by cash surrender value of life insurance.

C. Waivers

The waiver process is not used extensively because it is very laborious. It is also very redundant and duplicative, because it is our understanding and experience that each waiver request requires the same extensive set of supporting documentation regardless of the time lapse between waiver requests. Finally, although generally reasonable, the waiver process is too lengthy to be effective in day-to-day practice. Said another way, high quality borrowers will not wait or tolerate the delay in getting a waiver for their loan(s). While "blanket" or more broad waivers can be requested to cover multiple situations and perhaps prevent the individual delays; it is hard to anticipate each borrower request and have the appropriate wavier in hand. The result is often the inability to acquire or keep the highest quality borrowers. On the other hand, the lesser quality borrowers have fewer choices and generally have to tolerate the delays. Over a period of time this results in a skewing of the portfolio to potentially lesser quality.

In summary the MBL Rule or any regulation can not contain enough provisions to effective and efficiently prevent losses. The rule encourages emphasis on collateral which leads to a false sense of security because as previously mentioned, collateral is seldom adequate to pay back a loan. It places much less emphasis on experienced lenders and staff and also on the proper software and infra structure which are critical to correctly underwrite and monitor commercial loans. In addition most available CU systems are poorly equipped for commercial lending.

There is no incentive for a credit union to "invest" in experienced personnel or systems because everyone falls under the same MBL Rule. We would propose that if the MBL Rule continues in its current collateral oriented structure that additional leeway would be granted to CUs with more experienced staff. This could take the form of higher or no LTV limits and selected automatic waivers. We believe that experienced lenders will generally do what is prudent without regulatory limits. Commissions are seldom paid to commercial lenders and thus generally preventing the temptation to approve/recommend poor quality loans. Community banks and thrifts do not have a separate rule for commercial loans. Credit unions need to have the ability to compete for high quality and low risk borrowers who also have higher service expectations. These expectations are difficult to meet with the current restrictive MBL Rule.

We sincerely appreciate the NCUA seeking comments from credit union practitioner to provide input on NCUA's proposed rule making amending the MBL regulation. If you have questions please contact Larry Accola at 715-833-8268 or larry.accola@rcu.org.

Sincerely,

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